OCTOBER 2019

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FRANCHISE CONNECTION

A NEWSLETTER FOR FRANCHISEES, PROSPECTIVE FRANCHISEES & RESTAURANT OWNERS

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PART 2: Reduce Taxes and Defer Capital Gains through QOZs

by Gregorty Banner, CRTP

This is a continuation from our last newsletter article on tax reduction strategies from the sale of a franchise or business. In the first part we discussed Qualified Opportunity Zones (QOZ) and their ability to defer capital gains, reduce taxes and provide the opportunity for tax-free growth by reallocating part or all of one's taxable capital gains into a Qualified Opportunity Fund (QOF) for at least the 10 year holding period required to take advantage of all the benefits of the law.

Below are some practical examples of how you might consider using this strategy.

To Recap, Qualified Opportunity Zone (QOZ): The Tax Cuts and Jobs Act of 2017 established tax incentives for investors to invest in under-developed markets called "Opportunity Zones.

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Now, let's discuss a QOF in a little more detail. In order to take advantage of the tax law; capital gains must be invested into a QOF which is an entity that is classified as a partnership or corporation for federal income tax purposes. Once established, QOFs can invest in either real estate assets located inside of an Opportunity Zone (OZ) or invested in QOZ stock in a business that is located inside of an OZ.

There are many detailed rules related to tests and requirements for QOFs to stay in compliance which are beyond the scope of this article. Feel free to contact the author for more detail.

Denny's Franchise Sale Example

Jack decided to retire and sold his Denny's franchise today for $3 million. He has a basis of $1 million from his investment and realizes $2 million of long-term capital gains from owning it more than one year.

- Jack now has 180 days including the sale date to make an investment of a portion or up to the $2 million of gains into a QOF.
- Jack keeps the original $1 million basis amount immediately with no tax consequences.
- Jack decides to invest the full $2 million of capital gains into the QOF that is invested in apartment buildings and holds it for 10 years.
- After 7 years, Jack would owe Federal income taxes on $1.7 million of deferred capital gains, which would be $404,600. The new law allows for only 85% if the deferred capital gain amount to have to be taxed after meeting the 7 year holding period.
- For illustration purposes, let's assume that over the 10 years of investment, the value of the QOF Jack invested in doubled and was liquidated.
- Jack's original $2 million investment now pays him $4 million all tax-free.

In summary, the taxpayer would receive the $4 million tax free plus his original $1M in Denny's basis and have paid long-term capital gains taxes of $404,600 Federal income taxes on $1.7 million from the original sale. Depending on the type of QOF investment made, there is also the possibility Jack will receive income distributions along the way.

For the tax calculations and example simplicity, we are assuming Jack is a resident of a no income tax state.

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Burger King Building Sale & KFC building purchase Example

5 years ago, Jack bought the building his Burger King restaurant is located in for $500,000 adjusted basis. He then sold it to the new franchise owner for $1 million.

- Jack considered a 1031 tax-free exchange but wanted to take some cash off the table and defer the taxes. However, he didn't want to have to reinvest the entire $1 million into a new property in order meet the 1031 exchange requirements. (A 1031 tax-free exchange is always an option with real estate but is out of the scope of this article and potential depreciation recapture needs to be accounted for).

- Jack ends up deciding on investing the $500,000 of long-term capital gains for the 10 years of the QOF and taking the $500,000 of original basis for immediate use for other purposes.

- After 7 years, Jack would only owe Federal income taxes of $101,150 on the $425,000 of deferred capital gains.

- For illustration purposes, let's assume that over the 10 years, the value of the QOF Jack invested in doubled and was liquidated. Jacks original $500,000 investment now pays him $1 million all tax-free.

For tax calculations and example simplicity, we are assuming Jack is a resident of a non income tax state.

The next step to this example is that Jack decided to invest those funds into a KFC building or franchise located inside of an Opportunity Zone. Jack could create his own QOF (this is a bit costly and complex so typically requires larger investment amounts) and the $500,000 of proceeds could be invested into a new franchise or potentially an existing franchise assuming certain rules are met.

For more information on Qualified Opportunity Zones please reach out to the articlesauthor Gregory Banner CRTP at 858-455-1825 or gregbanner@asset-preservation.com. Greg is a licensed tax professional helping his clients minimize the tax consequences of decisions they make. "Securities Offered through Arete Wealth Management, member FINRA/SIPC/NFA"

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THE OUTLOOK FOR FRANCHISE M&A IN 2020

TUESDAY; NOVEMBER 12TH
9:45AM - 10:35AM

NFS Principal Alan F. Gallup will participate in a forward looking discussion of franchise sales with other industry professionals

www.restfinance.com/RFDC/

SELECT RECENTLY COMPLETED TRANSACTIONS

SOLD Applebee's GRILL & BAR	SOLD TACO BELL	SOLD The Melting Pot a fondue restaurant	SOLD the COUNTER CUSTOM BURGERS
29 Units | Midwest	Texas	Oregon	2 Units | California
SOLD JIMMY JOHN'S	SOLD KFC	SOLD FIVE GUYS BURGERS and FRIES	SOLD Denny's
4 Units | Arkansas	Oregon	5 Units + Dev California	Texas

NFS SPOTLIGHT: JEFF JONES

JEFF JONES
ADVISOR
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Jeff Jones, having owned 37 franchise restaurants in 5 brands throughout three states, has gained a unique ownership experience, which is so valuable when assisting his clients with their acquisition or resale needs.

Currently, Jeff and his wife Connie Jones own 6 Denny's restaurants and 2 Oggi's Pizza Brewhouse restaurants in California. Previous brands they have owned include Wendy's, Captain D's Seafood, and Wienerschnitzel.

Jeff first began assisting others with their franchise resales needs over 25 years ago. He has since assisted buyers and sellers in hundreds of transactions throughout the Country in most major franchise concepts.

Jeff is married to Connie Jones. They reside in San Diego, Ca., where they have three children, all of whom work with the family brokering and restaurant efforts. jeff is an alumni of San Diego State University.

BRAND SUMMARY: EL POLLO LOCO

by Michael Ingram | NFS El Pollo Loco Brand Specialist

El POLLO LOCO originated in 1975 in Guasave, Mexico where the founder started with a small roadside chicken stand serving chicken the way his mother had always prepared it - marinated in herbs, spices and citrus juices, and then flame-grilled to perfection.

El Pollo Loco's unique appeal over the past 30 years has established strong brand awareness. For customers, the El Pollo Loco brand name is equated with receiving healthy, fresh food in a quick service style. The El Pollo Loco brand continues to grow and accommodate its base

MICHAEL J. INGRAM
VICE PRESIDENT
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Franchisee Qualifications:

- Minimum 5 years of very recent or current restaurant experience as a multi-unit owner or primary operator
- Financial requirements of minimum net worth of $1M per unit or $300k per unit in liquid assets
- Compatible business philosophies